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DEPT FOR WHA/AND,/EPSC (FCorneille), EB/ESC/IEC(Izzo)
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TREASURY FOR J. LEVINE
STATE PASS TO EXIM, OPIC, TDA
DEPT OF ENERGY FOR S. LADISLAW
ENERGY INFORMATION ADMINISTRATION FOR CHARLES ESSER

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SUBJECT: BIOFUELS IN PERU PROMISING

REF: A)State 164558 (B)Lima 3686 (C)State 128599 (D)Lima 4044

11. (U) SUMMARY. Biofuels show promise for Peru, particularly sugar-based ethanol and a newly-discovered source for bio-oil. Ethanol blends can produce cleaner fuels for polluted cities; trade preferences make ethanol attractive for export. A U.S. and several Peruvian firms have projects underway. Peru's once thriving sugar cane industry stagnated under past governments but is now rebounding; Peru's coast may have the perfect conditions for sugar cane. Existing GOP incentives remain insufficient but are improving. A U.S. firm's project involving the fast-growing samoafiber plant will produce bio-fuel for ethanol conversion plants; samoafiber could provide an alternative to coca. Peru's extensive Amazon trade with Brazil makes it a logical partner for biofuel development. END SUMMARY.

ENERGY PRODUCTION IN PERU

12. (U) Peru remains a net energy importer, but when the Peru Liquefied Natural Gas (LNG) export project comes online in 2010, Peru will become a net exporter. Electricity generation comes primarily from hydroelectric and diesel power plants; in some areas directly related to the Camisea natural gas project (Lima and Pisco), factories and power plants are powered by natural gas; in addition, some distant users, such as the Yanacocha mine in Cajamarca, have converted to trucked natural gas. Liquefied Petroleum Gas (LPG) supplies heating and cooking needs in the mountains and coast; LPG is produced at Peru's four oil refineries in the jungle, on the coast, and at the Camisea fractionation plant in Pisco. Piped natural gas is increasingly used for cooking in the Lima metropolitan area where one third of Peru's population lives (Ref B).

13. (U) Peru's offshore oil production (near Ecuador) is one of the oldest in South America, but the bulk of Peru's current domestic oil production, as well as the concession blocks now being developed, are in the upper Amazon basin (also in the north). Two of Peru's four refineries are east of the Andes. Poor transportation infrastructure is a barrier to bringing Amazon gasoline to major markets: the coastal and mountain cities. Amazon oil is heavy, and

the gasoline remains high in sulfur; as a result, the major cities suffer serious air pollution.

¶4. (U) Vehicle power comes primarily from high sulfur diesel fuel refined in Peru. Government incentives have caused many vehicle owners to convert to either LPG or vehicular natural gas (called GNV in Peru); while new GNV retail stations are planned, at this time there are only two operating in Peru. Conversion of vehicles to gas power has been slow and gasoline and diesel, potentially with biofuel components, will remain the major vehicle fuels for years. With no public transportation of any kind in Peru's major cities, incentives for biofuels have targeted the private owners that operate buses and taxis.

SUGAR CANE NOW MORE PROFITABLE

¶5. (U) Up until the early 1970's, Peru had a thriving and efficient sugar cane industry along the arid but fertile coast. The Velasco military government expropriated large agroindustries in 1968, and gave the sugar cane fields to small farmers. (Agriculture ministry contacts told us how Peruvian cane producers went to Brazil and founded profitable sugar cane operations.) Sugar cane production has languished until recently as small farmer cooperatives had been unable to produce efficiently.

¶6. (U) The sugar industry is now becoming more profitable, following a long privatization process for sugar mills and improved irrigation systems. USDA data indicates Peruvian sugar cane production employs over 250,000 people with 81,000 hectares (ha) of sugar cane currently planted; an additional 68,000 ha are slated for planting. Domestic demand is about one million metric tons (mt). While Peru's annual production of 950,000 mt dropped last year due to drought, we expect production this year to return to the past average. Yields per hectare and production costs vary greatly among different operations.

¶7. (U) A recent consolidation of the sugar industry reflects new confidence in sugar cane production. The Gloria food corporation acquired Casa Grande sugar company and is in the process of increasing the Casa Grande operation from 12,000 to 32,000 ha. 25,000 ha should be planted by next year, coming into production the following year. This highly efficient operation, producing 85 to 90 mt/ha, should put Peru on track to supply its domestic sugar demand.

THE WORLD'S BEST PLACE TO GROW SUGAR CANE FOR ETHANOL?

¶8. (U) Ethanol has potential that varies with Peru's geography. In the arid but fertile coast, from which most agricultural exports come, sugar plantations are a profitable option if the land can be irrigated. The CEO of Maple Gas Peru, a U.S. investor committed to ethanol production, noted that Peru might be the best place in the world to grow sugar cane for ethanol, because of the predictable climate (it does not rain) - so long as there is sufficient irrigation. In the arid coast, irrigated water can be shut off to reliably provide the necessary dry period for fructose concentration.

¶9. (U) The Andean Trade Promotion and Drug Eradication Act (ATPDEA) provided tariff preferences for ethanol export to the U.S. Several firms have told us that this was the deciding factor for their decision to invest in sugar cane/ethanol. At least four firms have committed investments to ethanol operations; a number of other private companies and trade associations are evaluating the opportunities associated with a conversion to ethanol production.

¶10. (U) A promising ethanol project was launched in 2001, at the beginning of President Toledo's term. With around 10,000 ha committed to feed the proposed plant in the coca-growing area of the San Martin Department, the project could have provided an alternative to coca cultivation. The GOP was backing a proposed ethanol pipeline that would have tracked with the existing northern oil pipeline; the project was abandoned when the main proponent, Vice President Raul Diez-Canseco, resigned after a scandal.

¶11. (U) There is currently no biofuel production in Peru. Industry and government experts tell us that delays have been due to its comparatively high cost, the state of technology and a lack of

subsidies. Some industry observers have told us that the current high oil prices make it a more attractive economic proposition to produce ethanol for export-and domestic consumption too, although Peru's fuels market is relatively small. Barriers to consumer acceptance of ethanol blends include misconceptions and old engines.

A Sugar Producers' Association official noted to us that more domestic investment in ethanol will not happen until the government provides additional incentives.

GOP INCENTIVES SMALL BUT GROWING

¶12. (U) The Peruvian Congress passed a law in 2003 to promote the use of "biofuels;" under the 2005 implementing regulations, gasoline suppliers are authorized to substitute ethanol for the contaminating components of high sulfur fuels. The law authorizes domestic fuel suppliers to sell gasoline with up to 7.8 percent ethanol content and diesel up to 5 percent ethanol content. The Ministry of Energy and Mines (MEM) plans to submit new regulations to permit 100 percent of diesel fuels to be biodiesel. A major industry criticism is that the biofuel law does not currently offer any tax incentives; biofuels are still subject to excise IGV taxes. A Minister of Agriculture official told us the GOP is trying to insert biofuel regulations into the law for the promotion of agriculture. (Biofuel regulations are currently associated with a Production Ministry law.) A proposed regulation would allow ethanol producers to import machinery and equipment tax free.

¶13. (U) The Garcia administration is determined to promote exports as a way to develop the country, and agricultural based exports are at the top of the list. President Garcia and his ministers - Agriculture, Mining and Energy and the heads of relevant agencies dealing with environment, investment promotion and counterdrug issues have all expressed interest in ethanol production. They have also shown a strong interest in public-private partnerships and in attracting foreign investment for energy.

¶14. (U) President Garcia's "Water for Everyone" is one of his top priorities, designed to provide safe water treatment as well as increased water for irrigation. In the coast, decent port facilities make ethanol export relatively easy. Much agricultural land in the north is devoted to water-hungry rice, which many think could and should be converted to sugar cane production for ethanol. Implementation of Water for Everyone by the Ministries of Agriculture (irrigation) and Housing (water treatment for municipalities) should lead to more water available for sugar cane production.

AGRICULTURAL RESEARCH ESSENTIAL

¶15. (U) In a meeting with the visiting State Department Science Advisor on 11/3, representatives from the GOP's science and technology coordinating agency declared that biofuel research was one of Peru's research priorities. This was echoed by representatives from Peru's leading agricultural and engineering universities during the same visit: research coordinators said biofuel research would be spurred along several avenues: irrigation to increase coastal hectares for sugar cane; plant genetics to produce faster-growing sugar cane and jungle cellulose species; and biofuel production technology. (Note: Post will also explore how jungle biofuel species could fit into alternative development programs, as fast-growing cash crops are a logical alternative to coca. End Note.

ETHANOL PROJECTS UNDERWAY

¶16. (SBU) Four Peruvian firms have ethanol projects underway. U.S. firm Maple Gas Peru is currently an oil producer and refiner in the Amazon basin, and is now investing in ethanol. Maple has almost completed the groundwork for an extensive ethanol export operation. The water rights and plant construction permits are basically finished, and the firm is now adding to its hectareage. Planting is planned to begin next year. This firm's history of successfully negotiating its way through various local, regional and national water and titling authorities could be a model for other foreign ethanol projects. The head of the Chinese-Peruvian Chamber of Commerce announced recently that Chinese investors have proposed to the GOP investment in an ethanol plant on the northern coast.

JUNGLE BIO-OIL: EXCITING NEW FIND

¶17. (U) A U.S.-based company, Somoa Fiber Holdings (SFH) met with President Garcia in September, who promised support (but no funds) for development of bio-oil from an Amazon reed, the SamoaFiber (Ref D), using new technology that can hydrolyze the cellulose into starch for ethanol. The SFH CEO told us that he would export the bio-oil (or supply Peruvian plants when built) for conversion to ethanol. SamoaFiber (called cana brava in Peru) reportedly is endemic to Peru and is one of the fastest-growing plants known.

OTHER BIOFUEL POTENTIAL IN THE JUNGLE

¶18. (U) Grupo Romero, one of the largest food conglomerates in Peru, and a major sugar producer, has recently announced a soy project in the jungle geared towards biofuels. In the highland and lowland jungles, conditions are relatively similar to Brazil's cane-producing areas. Logistical obstacles to both building ethanol plants and transport to market are the main obstacles; insufficient roads exist to the coast, although road infrastructure is also one of President Garcia's priorities. Riverine export through Brazil, as occurs now with wood products, would be a good alternative. In the mountains, ethanol-appropriate crops such as potatoes and corn are staples; economic development in the southern sierra is one President Garcia's top domestic priorities.

USG OPPORTUNITIES

¶19. (U) Supporting Peru's suitability in both Amazon and coastal zones for biofuel development could help reduce Peru's oil imports. Possible avenues of how the USG might support biofuels production and domestic consumption in Peru include environmental (no environmental regulations are currently planned for ethanol); plant research (Ministry of Agriculture and Agrarian University); economics of ethanol (alternative development); and water engineering. Support in these areas could synchronize with other USG efforts such as EPA's Clean Fuels Initiative and Advancing U.S. Efforts on Water (Ref C).

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